89-2016

No.

Supreme Court, U.S.
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# In the Supreme Court of the United States

OCTOBER TERM, 1989

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

ASSOCIATED GAS DISTRIBUTORS, ET AL.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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## QUESTION PRESENTED

This case involves the validity of orders of the Federal Energy Regulatory Commission that establish a prospective change in rates charged by a natural gas pipeline to its customers to reflect current costs incurred by the pipeline in settling its liability under "take-or-pay" clauses in its contracts with natural gas producers. A take-or-pay clause obligates the pipeline to purchase a certain amount of gas from the producer and to pay a specified price for that amount even if the pipeline does not take the gas.

The question presented is:

Whether the Commission orders violate the provisions of Sections 4 and 5 of the Natural Gas Act of 1938, 15 U.S.C. 717c and 717d, that comprise the "filed rate doctrine," because the orders allocate the pipeline's costs of settling its take-or-pay liability among its current customers based on the extent to which a past decline in each customer's purchases from the pipeline contributed to the pipeline's "take-or-pay" liability to producers.

## PARTIES TO THE PROCEEDING

In addition to the Federal Energy Regulatory Commission, the parties to the proceedings in the court of appeals were:

Alabama-Tennessee Natural
American Iron and Steel Institute
American Paper Institute, Inc.
Arco Oil and Gas Company
Arkla, Inc.
Associated Gas Distributors
Baltimore Gas & Electric Company
Berkshire Gas Company, et al.
Brooklyn Union Gas Company
Cabot Corporation
Central Hudson Gas and Electric Corp.
Chattanooga Gas Company
Cities of Clarksville, Springfield and Portland, Tennessee, and Humphreys County Utility District
CNG Transmission Corporation
Columbia Gas Distribution Companies
Columbia Gas of Kentucky, et al.
Columbia Gas Transmission Corp.
Connecticut Natural Gas Corp.
Consolidated Edison Company of New York, Inc.
Dayton Power & Light Company
East Tennessee Group
Equitable Gas Company
Inland Gas Company, Inc.
Long Island Lighting Company
Maryland People's Counsel
Nashville Gas Company
National Fuel Gas Supply Corp.
New York State Electric & Gas Corporation

North Carolina Utilities Comm.
North Penn Gas Co.
Northern Illinois Gas Co.
Northern Indiana Public Service Company
Office of Consumers' Counsel, State of Ohio
Orange & Rockland Utilities
Niagara Mohawk Power Corp.
Pennsylvania Gas & Water Company
Pennsylvania Public Utility Commission
Peoples Natural Gas
Peoples Gas Light and Coke Co.
Process Gas Consumers Group
Public Service Commission of New York
Public Service Electric & Gas Company
Rochester Gas & Electric Corp.
Shell Offshore Inc. and Shell Western E&P Inc.
Southern Natural Gas Company
Tennessee Gas Pipeline Company
Tennessee Small General Service Customer Group
Texas Eastern Transmission Corporation
Transcontinental Gas Pipe Line Corporation
United Gas Pipe Line Company
Washington Gas Light Company
Western Kentucky Gas Company

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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The Acting Solicitor General, on behalf of the Federal Energy Regulatory Commission, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

## OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-25a) is reported at 893 F.2d 349. The opinions on denial of rehearing en banc (App., *infra*, 137a-142a) are not reported. The orders of the Federal Energy Regulatory Commission dated February 8, May 27, July 8, and July 28, 1988 (App., *infra*, 26a-136a) are reported at 42 F.E.R.C. ¶ 61,175, 43 F.E.R.C. ¶ 61,329, 44 F.E.R.C. ¶ 61,039, and 44 F.E.R.C. ¶ 61,155, respectively.

## JURISDICTION

The judgment of the court of appeals (App., *infra*, 143a-144a) was entered on December 28, 1989, and petitions for rehearing were denied on March 30, 1990 (App., *infra*, 137a-142a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATUTORY PROVISIONS INVOLVED

Sections 4 and 5 of the Natural Gas Act of 1938, 15 U.S.C. 717c and 717d, are reproduced at App., *infra*, 145a-149a.

## STATEMENT

The court of appeals in this case held that orders issued by the Federal Energy Regulatory Commission, which establish prospective rates to be charged by a pipeline to recover a portion of the costs incurred in settling contractual liabilities to gas producers, violate the "filed rate doctrine." App., *infra*, 6a-11a. This Court has described that doctrine as "forbid[ding] a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co* v. *Hall* [*Arkla*], 453 U.S. 571, 577 (1981). At bottom, the filed rate doctrine is simply a label attached by the courts and others to describe provisions in various regulatory Acts of Congress that prescribe the procedures and substantive standards to be followed in setting rates and the effect that must be given to those rates. See, *e.g.*, *Arkla*, 453 U.S. at 577-578. For this reason, a case involving the filed rate doctrine is nothing more or less than a case of statutory construction. See *Maislin Industries U.S., Inc.* v. *Primary Steel, Inc.*, No. 89-624 (June 21, 1990), slip op. 9, 10-11, 12-13, 14-15. It therefore is useful at the outset to describe the statutory framework under which the present case arises.

**A. The Statutory Framework**

Natural gas companies as an initial matter set their own rates for the sale or transportation of gas, typically by contract with their customers. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 341 (1956). However, Section 4(a) of the Natural Gas Act of 1938 (NGA), 15 U.S.C. 717c(a), provides that all rates received by a natural gas company in connection with the sale or transportation of gas subject to the jurisdiction of the Commission shall be "just and reasonable," and "any such rate or charge that is not just and reasonable is declared to be unlawful." Section 4(a) does not confer a right enforceable by the courts in the first instance. Rather, "the prescription of the statute is a standard for the Commission to apply," and "the right to a reasonable rate is the right to the rate which the Commission files or fixes." *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951).

To preserve the Commission's primary jurisdiction over this and other statutory prescriptions, Section 4(c) of the NGA, 15 U.S.C. 717c(c), requires a gas company to file with the Commission all proposed rates and contracts for the sale or transportation of gas, which then may be modified or rejected by the Commission. Under Section 4(d), a gas company may not make any change in a filed rate, classification, or service, or in any rule, regulation, or contract relating thereto, "except after thirty days' notice to the Commission and to the public." 15 U.S.C. 717c(d). If a rate change is one the gas company has the contractual power to make, it is "completed upon compliance with the notice requirement and the new rate has the same force as any other rate—it can be set aside only upon being found unlawful by the Commission." *Mobile Gas*, 350 U.S. at 342. The Commission does, however, have authority under Section 4(e) of the NGA, 15 U.S.C.

717c(e), to preserve the status quo pending its review of a new rate by suspending the proposal for not more than five months, and thereafter to make its order retroactive to the date the change became effective and to order a refund of any proposed rates found to be unjust or unreasonable. See *Mobile Gas*, 350 U.S. at 341.

The Commission also is empowered to review existing rates and practices of natural gas companies. Section 5(a) of the NGA, 15 U.S.C. 717d(a), provides that if the Commission finds after a hearing that any rate charged by a gas company, or any rule, practice or contract affecting a rate or classification, is unjust, unreasonable, unduly discriminatory, or preferential, "the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." The Commission cannot, however, impose a retroactive rate alteration under Section 5(a), and it has no power to order payment of reparations if it finds that rates previously in effect were unjust or unreasonable. See *Arkla*, 453 U.S. at 578; *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 24 (1968); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944). Under the statutory standard of "just and reasonable" in Section 5(a), like that in Section 4(a), "it is the result reached not the method employed which is controlling. * * * If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Hope Natural Gas Co.*, 320 U.S. at 602. See also *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968); *Duquesne Light Co.* v. *Barasch*, 109 S. Ct. 609, 617 (1989).

**B. The Background Of The Take-Or-Pay Problem**

1. This case arises from the Commission's attempts to address the problem of "take-or-pay" clauses in con-

tracts that many pipelines entered into with producers between 1977 and 1982, when the price of natural gas was much higher than it is today. See Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles ¶ 30,867, at 31,509 (Dec. 13, 1989). A take-or-pay clause obligates a pipeline to purchase a certain amount of gas at a specified price and to pay for the gas even if it is not taken. Such clauses permit a pipeline to make up a deficiency by purchasing additional gas over a succeeding period, typically five years. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 412 (1986).

By 1982, the supply of natural gas began to exceed demand, primarily because of the price incentives and phased deregulation schedule for "new" gas under the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq*. Demand for natural gas then began to fall, due to warm winters, a recession, and customers' switching to alternative fuels when world oil prices fell dramatically. As a result, by the end of 1983, the take-or-pay exposure of pipelines already exceeded $5 billion. Order No. 500-H, FERC Stats. & Regs. at 31,510.

The price of natural gas continued to rise even as demand fell, because pipelines generally had monopoly power over their service areas. At the time, most pipelines were essentially merchants: they purchased gas from producers, transported the gas, and then resold it to local distribution companies (LDCs) or, in some instances, to other interstate pipelines or end users. Typically, the LDCs in a given area were served by only one pipeline, which refused to transport gas that LDCs and end users purchased directly from producers if to do so would compete with the pipeline's own sales. This regime was maintained by the "minimum bill" provisions in many tariffs,

which obligated LDCs to pay a portion of the pipeline's costs, including the cost of gas, even if the LDCs did not purchase gas from the pipeline. "These practices frustrated the move toward a competitive wellhead market initiated by Congress in the NGPA, since purchasers could not obtain access to cheaper sources of supply than those provided by the pipelines, for example, by purchasing directly from the producer." Order No. 500-H, FERC Stats. & Regs., at 31,510.

In the early 1980s, the Commission, in an effort to effectuate the more competitive wellhead market instituted by the NGPA, moved to eliminate the minimum bill arrangement between pipelines and their customers, finding it anticompetitive. Order No. 380 [1] required pipelines to eliminate their variable costs from all minimum bills. That order was essentially sustained in *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). Minimum bills thereafter were eliminated altogether on a case-by-case basis. Order No. 500-H, FERC Stats. & Regs., at 31,510-31,511; see, *e.g.*, *East Tennessee Natural Gas Co.* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988); *Transwestern Pipeline Co.* v. *FERC*, 820 F.2d 733 (5th Cir. 1987), cert. denied, 484 U.S. 1005 (1988). As a result, customers were no longer legally obligated to purchase a certain amount of gas from a particular pipeline, and pipelines were no longer guaranteed a minimum amount of revenue.

Elimination of the minimum-bill device did not immediately free LDCs and other pipeline customers to obtain gas from other sources to supply. Pipelines retained their monopoly positions in local markets and refused to

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[1] *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, FERC Stats. & Regs., Regulations Preambles [1982-1985] ¶ 30,571 (June 1, 1984).

transport gas that would displace their own sales and thereby increase their take-or-pay liability. The Commission initially sought to address this problem by granting pipelines the incentive of blanket certificates to transport gas, albeit only on behalf of lower-priority customers who could readily switch to other fuels and who could therefore leave the pipeline system altogether. These orders were invalidated by the D.C. Circuit because the Commission had not adequately explained why the benefit of free access to competitively priced gas at the wellhead was not extended to captive customers of the pipeline. *Maryland People's Counsel* v. *FERC*, 761 F.2d 768 (D.C. Cir. 1985), and 768 F.2d 450 (D.C. Cir. 1985). See Order No. 500-H, FERC Stats. & Regs. at 31,511.

2. These events led to the much broader approach the Commission took in 1985 in Order No. 436,[2] which "envisage[d] a complete restructuring of the natural gas industry." *Associated Gas Distributors* v. *FERC* (*AGD I*), 824 F.2d 981, 993 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). In Order No. 436, the Commission instituted a program to encourage open access to all major pipelines, so that LDCs and other customers could purchase gas directly from producers. The Commission found the pipelines' practice of refusing to transport gas in competition with their own sales to be unduly discriminatory because it denied consumers access to gas at the lowest reasonable prices. The Commission also found that the practice was frustrating the NGPA's goal of relying on a competitive wellhead market in reducing prices. To correct

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[2] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles [1982-1985] ¶ 30,665 (Oct. 9, 1985).

that situation, Order No. 436 required pipelines seeking blanket authorization for transportation to become open-access pipelines, prohibited pipelines from refusing to transport gas in competition with their own sales, and required open-access pipelines to allow their firm-sales customers to convert their contract demand rights (the right to purchase a specified amount of gas from the pipeline) into a right to firm transportation of gas by the pipeline. See *AGD I*, 824 F.2d at 996, 1016-1018; Order No. 500-H, FERC Stats. & Regs., at 31,512.

The D.C. Circuit sustained most features of Order No. 436 in *AGD I*, but remanded for further proceedings on certain issues. In particular, the D.C. Circuit held that the Commission had erred in failing either to address the pipelines' take-or-pay problems in connection with its new open-access policy or to explain adequately its reasons for not doing so. The court was concerned that Order No. 436 would enable more pipeline customers to purchase cheaper gas directly from producers, thereby increasing the pipelines' take-or-pay exposure, and would deny pipelines bargaining leverage in settling their take-or-pay liability with producers. See *AGD I*, 824 F.2d at 1020-1030.

On remand following *AGD I*, the Commission adopted Order No. 500, an interim rule that instituted a policy of "equitable sharing" of take-or-pay liability across the natural gas industry—*i.e.*, among producers, pipelines, and customers. The final version of this rule, Order No. 500-H, was issued on December 13, 1989.[3] Order No.

[3] Order No. 500 was issued as an interim final rule and policy statement in August 1987. FERC Stats. & Regs., Regulations Preambles ¶ 30,761. Order No. 500-H was issued on the limited remand in *American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989) [*AGA*], in which the court considered challenges to Order No. 500. Order No. 500-H, as modified on rehearing by Order No. 500-I, FERC Stats. & Regs., Regulations Preambles ¶ 30,880 (Feb. 12, 1990), is now pending on judicial review in *AGA*, following that limited remand.

500-H essentially retains the provisions of Order No. 436 that prescribe incentives for pipelines to assume open-access status and permit customers to convert contract demand rights to transportation rights. See 18 C.F.R. 284.10. Order No. 500-H also encourages producers and pipelines to enter into settlements under which the pipelines would "buy down" their existing take-or-pay contracts by reforming the pertinent provisions and "buy out" their accrued liability under those contracts. To furnish an incentive for producers to agree to such settlements, the Order permits a pipeline to refuse to transport gas unless the producer agrees (with certain exceptions) to credit the transported gas against the pipeline's take-or-pay liability. Order No. 500-H, FERC Stats. & Regs. at 31,525-31,536; see 18 C.F.R. 284.8(f), 284.9(f).

Order No. 500-H also encourages pipelines and their customers to share the cost of payments made by pipelines for the portion of their take-or-pay exposure that producers do not absorb. The Order permits a pipeline to pass its prudently incurred buydown and buyout costs through to customers in their commodity gas sales rates, the traditional means of recovering costs. 18 C.F.R. 2.108(a). However, the Commission was concerned that open-access pipelines' loss of sales might accelerate if the price of gas was substantially increased by a straight surcharge. The Commission therefore designed an alternative mechanism for open-access pipelines to share with their customers a portion of the costs incurred in settling their take-or-pay liability. Under this alternative, if the pipeline agrees to absorb between 25% and 50% of the buydown and buyout costs, it may recover an equal amount by means of a direct charge to its customers, rather than a

surcharge on gas sold.[4] The pipeline then may attempt to recover the balance, if any, by means of a volumetric surcharge on both sales and transportation of gas. Order No. 500-H, FERC Stats. & Regs. at 31,574-31,576.[5]

The Commission determined that the costs not absorbed by the pipeline under the alternative method should be allocated fairly among its customers based upon their responsibility for the pipeline's incurring the take-or-pay liability. Accordingly, the direct charge imposed upon each customer is based generally upon the cumulative deficiency of purchases by that customer in recent years, as compared with its purchases during a representative prior period when the pipeline had not yet begun to accrue take-or-pay liability. App., *infra*, 4a, 85a; see 18 C.F.R. 2.104(b). Under this approach, known as the "purchase deficiency" method of allocation, customers who reduced their purchases from the pipeline to buy cheaper gas at the wellhead bear a greater share of the cost of resolving the pipeline's take-or-pay liability than more captive customers whose purchase levels remained relatively constant. Order No. 500-I, FERC Stats. & Regs., Regulations Pre-

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[4] A direct charge is a monthly bill from the pipeline to its customer over a defined period, perhaps between two and five years, that does not vary based on the amount of gas purchased (or not purchased) by the customer during the collection period.

[5] Order No. 500-H establishes a presumption that the portion of a pipeline's take-or-pay costs it does not absorb were prudently incurred. If a customer agrees to accept the settlement under Order No. 500-H, it cannot challenge that presumption. This procedure was designed to avoid lengthy hearings on prudence or blame for the take-or-pay problem. App., *infra*, 4a; *AGA*, 888 F.2d at 144; Order No. 500, FERC Stats. & Regs. at 30,787-30,788.

ambles ¶ 30,880, at 31,720 (Feb. 12, 1990); [6] Order No. 500, FERC Stats. & Regs. at 30,785, 30,786-30,787.

3. The Commission's "equitable sharing" policy has furnished a substantial impetus for producers and pipelines to settle the latter's take-or-pay liabilities. Through such settlements, pipelines have been able to reduce their current take-or-pay liabilities by $16 billion and, through contract reformation, to obtain future relief in the amount of $28 billion. At the end of 1989, pipelines had paid producers approximately $8.6 billion to obtain this relief, or an average of 18.6 cents on each dollar of liability. Of this $8.6 billion, pipelines have absorbed 39.3% ($3.4 billion), received an equivalent amount through direct billing of their customers under the "purchase deficiency" method, and assessed the remainder through volumetric surcharges on both sales and transportation. Order No. 500-H, FERC Stats. & Regs. at 31,522-31,523.

**C. The Proceedings In This Case**

1. This case involves an application of the Commission's "equitable sharing" policy to a particular pipeline,

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[6] The Commission explained on rehearing in Order No. 500-I, at 31,720:

> The Commission continues to believe that purchase deficiency allocation is the most equitable method for allocating the take-or-pay costs included in the fixed take-or-pay charge among pipeline customers because that method, while not perfect, most closely matches cost causation with cost incurrence. The pipelines entered into take-or-pay contracts to serve their firm customers' anticipated demand for gas. Accordingly, those customers' subsequent reduced demands for gas have caused the incurrence of the pipelines' take-or-pay costs. Other potential allocation methods do not match cost causation with cost incurrence as well as the purchase deficiency method because they are related solely to current demand levels or purchases and shipments of gas.

Tennessee Gas Pipeline. Under the Commission's final orders on Tennessee's settlement proposal, Tennessee is to absorb 50% of the payments it makes to producers to settle its take-or-pay liability, and the remainder is to be passed through to its customers according to the purchase-deficiency method of allocation. In applying that method, the Commission established the base period (prior to the sharp decrease in customer demand for Tennessee's gas) as 1981-1982, and the deficiency period (when the declines took place) as 1983-1986. Each customer's purchase deficiency, and thus its responsibility for a portion of the take-or-pay costs incurred by Tennessee, is calculated by comparing its purchases in the deficiency period with its purchases in the base period. App., *infra*, 4a-5a, 84a-87a, 90a-93a, 122a-124a.[7] Tennessee's customers may either

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[7] Tennessee initially proposed to absorb only 20% of its take-or-pay costs. The administrative law judge recommended that the proposal be modified so that Tennessee would absorb 50% of the costs and pass through the remainder to its customers. App., *infra*, 28a-29a. After the Commission issued Order No. 500, Tennessee filed a settlement proposal that generally tracked that Order. In its February 8, 1988, decision on review of the ALJ's decision, *id.* at 26a-66a, the Commission adopted the 50-50 division but approved a method for allocating costs among Tennessee's customers that departed from Order No. 500: the cost of buying out take-or-pay liabilities that had already accrued was to be allocated under a modified version of the purchase-deficiency method, while the cost of buying down (reforming) uneconomical contract provisions on a prospective basis was to be allocated based on the maximum amount Tennessee was obligated to deliver to the customer as of January 1, 1986. *Id.* at 28a, 30a, 46a-49a. In its May 27, 1988, order on rehearing, *id.* at 67a-108a, the Commission modified the formula to allocate the entire passthrough amount using the purchase-deficiency method. The Commission explained that since Order No. 500 was issued, it had approved four other proposals that allocated costs to customers under the purchase-deficiency method, and it found no sufficient basis to depart from that approach here. *Id.* at 82a-91a, 122a-124a.

pay this direct charge over a period of several years of current gas service or discharge their liability in a lump sum payment to Tennessee. *Id.* at 113a-114a, 130a-131a. The Commission also imposed a $650 million cap on Tennessee's recoveries from its customers. *Id.* at 39a-41a, 76a-81a.

The Commission rejected the contention by several of Tennessee's customers that because its order allocated take-or-pay costs among customers on the basis of past purchasing patterns, the order constituted "retroactive ratemaking" and therefore violated the filed rate doctrine. App., *infra*, 47a-49a, 94a. The Commission reasoned that its order does not impose a rate increase for gas already sold or permit Tennessee to recover past costs that should have been included in rates for a prior period. Instead, the Commission explained, the order prescribes an appropriate allocation of Tennessee's current settlement payments incurred in connection with current gas service, just as the costs of resolving any contract dispute are typically included in the pipeline's next rate filing. The Commission observed that "[i]f pipeline recovery of take-or-pay costs at the time they are paid were retroactive ratemaking merely because the costs relate back to some past event, a pipeline could never lawfully recover those costs under *any* rate treatment." *Id.* at 48a.[8]

2. A number of parties sought judicial review of the Commission's orders in the D.C. Circuit. Certain of Ten-

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[8] The Commission likewise rejected the retroactive-ratemaking objection in Order No. 500. There, it noted that Commission measures enabled pipeline customers to purchase gas from alternative sources at lower prices while pipelines accrued take-or-pay liability, and it found it "reasonable that the beneficiaries of Commission initiatives to increase competition in the natural gas industry should share in the transition costs which accompany the industry's restructuring." Order No. 500, FERC Stats. & Regs. at 30,787.

nessee's customers challenged the purchase-deficiency method of cost allocation on two grounds. First, they argued that allocation of responsibility for take-or-pay costs on the basis of past purchasing patterns violates the filed rate doctrine because it constitutes a retroactive change in rates without advance notice. Second, the customers argued that even if the filed rate doctrine is not violated, the purchase-deficiency mechanism is not "just and reasonable" within the meaning of Sections 4 and 5 of the NGA. The court held that the purchase-deficiency method violates the filed rate doctrine, App., *infra*, 6a-11a, and it therefore did not reach the question whether that method is "just and reasonable."

The court found it irrelevant for purposes of the filed rate doctrine that the Commission's orders allocate Tennessee's *current* costs (those incurred in its current buyout and buydown of take-or-pay liability), rather than *past* costs, and that the orders do so by a prospective increase in the filed rate.[9] In the court's view, the decisive question "is not which costs are 'current' and which are 'past.' Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached." App., *infra*, 9a. Accordingly, the court held that costs could not be allocated among Tennessee's customers on the basis of their purchase decisions during the base period (1981-1982) and the deficiency period (1983-1986), which they could no longer change. In so ruling, the court ex-

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[9] Under traditional ratemaking principles and Commission rulings, pipelines could not have charged their customers for take-or-pay liability as it accrued; only when the costs were incurred, through payment or settlement, could the costs be passed on. See Order No. 410, 44 F.P.C. 1142, 1143 (1970), aff'd *sub nom. Public Service Comm'n* v. *FPC*, 467 F.2d 361, 370 (D.C. Cir. 1972); *Panhandle Eastern Pipe Line Co.*, 32 F.E.R.C. ¶ 63,085, at 65,303 (1985).

pressed the view that "[p]roviding the necessary predictability is the whole purpose of the well established 'filed rate doctrine'." *Id.* at 10a (citations omitted). In a related vein, the court also concluded that Tennessee's customers did not have sufficient notice (at least prior to publication of Order No. 380 in June 1984) that they might later have to pay rates based in part on their purchases during that period. App., *infra*, 9a-10a.[10]

3. Petitions for rehearing en banc filed by the Commission and numerous other parties were denied by the court of appeals, with Chief Judge Wald and Judges Mikva and Edwards dissenting. App., *infra*, 137a-142a. In a statement on behalf of the three dissenters, Chief Judge Wald pointed out that the conversion provisions of Order No. 436 had enabled many customers to avoid their obligations to purchase a specified amount of gas from pipelines, and that, because those customers took advantage of the open-access regulatory regime to purchase gas elsewhere, they were responsible for the pipelines' accrual of

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[10] The court of appeals also addressed several other issues. First, ruling in the Commission's favor, it held that a pipeline's payments to a producer to buy out or buy down take-or-pay costs are not subject to the price ceiling in the NGPA. App., *infra*, 12a-17a. Second, the court held that the Commission should have either ordered that two customers be given credit for amounts they paid in prior settlements of their liability for certain of Tennessee's take-or-pay costs, or explained more completely its refusal to do so. *Id.* at 17a-23a. The court declined to resolve two other issues—whether the Commission should limit take-or-pay costs of sales subject to its jurisdiction pursuant to Section 5(a) of the NGA, and whether the March 31, 1989, sunset date for allocating take-or-pay liability is arbitrary and capricious—because those issues are raised on judicial review of Order No. 500 in the *AGA* case, which was (and is again) pending in the D.C. Circuit (see note 3, *supra*). App., *infra*, 23a-24a.

take-or-pay liability. App., *infra*, 141a-142a. She continued (*id.* at 141a):

> The FERC, then, did not "revise" these rates; circumstances subsequent to the signing of the contracts between the consumers and the pipelines altered the deal —and, in effect, the rate—originally agreed to by the consumers. The FERC's decision to reallocate some of these current costs did not violate the filed rate doctrine because the deal originally agreed to by the consumers had already been abrogated by the FERC. Neither the purchase decisions to which the consumers' original costs were attached nor the rates pursuant to them were still valid. It was a brand new world: there were no "old rates" to change.

The dissenting judges further observed that "[i]n a time when the structure of the natural gas industry is undergoing a sea change, the FERC must be granted considerable discretion to ensure that the transition period is handled in a manner that minimizes the disruption in the industry." App., *infra*, 141a. Indeed, they noted that in remanding Order No. 436, the D.C. Circuit in *AGD I* instructed the Commission "to do something about the pervasive take-or-pay contracts" that "hindered" pipelines from moving to open-access status, and in their view, Order No. 500 was "a good faith, and not unreasonable, response to the mandate." *Id.* at 141a-142a. By contrast, "[t]he panel's overly rigid interpretation of the filed rate doctrine * * * leaves the FERC essentially powerless to take care of the take-or-pay crisis," because a pipeline's prices would increase to a non-competitive level if take-or-pay costs were added as a surcharge to future sales, and even if some costs could be passed on in this manner, "that would still mean that total losses would be allocated *in*equitably." *Id.* at 142a. For these reasons, the dissenting judges concluded that the panel's decision will have a "significant effect * * * on the functioning of the industry and on the FERC's ability to regulate this 'quiet revolution' in the gas industry." *Ibid.*

## REASONS FOR GRANTING THE PETITION

The court of appeals has invalidated a central feature of the policy adopted by the Federal Energy Regulatory Commission to resolve the problem of "take-or-pay" contracts that has pervaded the natural gas industry for a number of years. The court has done so, moreover, by adopting a view of the "filed rate doctrine" that is divorced from the text and purposes of the relevant provisions of the Natural Gas Act and from this Court's explanation of those provisions and the filed rate doctrine in *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981). As a result, the court has expanded the doctrine well beyond its traditional bounds to impose rigid limitations on the allocation of concededly current costs, a subject that heretofore has been governed by the necessarily flexible principles embodied in the "just and reasonable" standard of rate regulation. The court also subordinated cardinal principles of regulation under the just and reasonable standard that seek to assign cost responsibility among customers based on cost incurrence. The decision below therefore raises fundamental and far-reaching questions, not previously considered by this Court, regarding the rights and obligations imposed upon the Commission and other agencies, as well as the entities they regulate, by the statutory provisions that embody the filed rate doctrine.

The decision below also is of enormous practical importance. The "equitable sharing" policy adopted by the Commission to spread the cost of resolving the take-or-pay crisis over all segments of the natural gas industry has thus far proven to be quite successful, resulting in the settling of approximately $44 billion of the pipelines' present and future take-or-pay exposure and other related relief at a cost to the pipelines of approximately $9 billion. Of that $9 billion, almost $3.4 billion has been passed through to pipeline customers under the purchase-deficiency method of allocation. If the decision below is permitted to stand, much of this passthrough will have to be undone, and the

Commission will have to conduct still further proceedings in this case and many others, as well as its generic Orders Nos. 500-H and 500-I, to come up with and institute another means of allocating take-or-pay costs among pipeline customers. During such proceedings, the problem of take-or-pay liability will continue to pervade the relationship between pipelines and their customers, and thereby disrupt and delay a smooth transition to the truly competitive market Congress intended when it enacted the Natural Gas Policy Act of 1978 and the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157. An appellate decision so far-reaching and disruptive in its effect, and so unsupported by legal precedent, should not go unreviewed by this Court.

1. In announcing its expansive view of the filed rate doctrine, the court below fundamentally misapplied the governing statutory provisions and ignored its duty under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837 (1984), to defer to the reasonable interpretation of those provisions by the Commission.

a. The court of appeals invalidated the Commission orders at issue here without even discussing the terms of the statutory provisions under which they were issued, Sections 4 and 5 of the Natural Gas Act (NGA), 15 U.S.C. 717c and 717d. See App., *infra*, 6a-11a. The court proceeded instead as if the "filed rate doctrine" were a *judicially* fashioned rule that can be expanded by the courts in a common-law manner, according to their own perception of its underlying "purposes." In fact, however, the term "filed rate doctrine" is merely a label attached to a set of statutory provisions in the NGA and similar Acts of Congress that prescribe the procedures and substantive standards to be followed in setting rates and the effect that such rates must be given by the courts and others. The court below therefore should have grounded its analysis in the statutory provisions through which *Congress* articulated the particular rules that comprise what has come to

be known as the "filed rate doctrine." The Commission's orders in this case are fully consistent with the text and purposes of those provisions.

As relevant here, the filed rate doctrine is principally embodied in Section 4 of the NGA. Section 4(a) provides that all charges made or received by a natural gas company, and all rules and regulations affecting such rates or charges, shall be "just and reasonable," and any rate or charge that is not just and reasonable is deemed unlawful. Section 4(c) requires every natural gas company to file with the Commission "schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission," the classifications, practices, and regulations affecting such rates and charges, and contracts affecting rates, charges, classifications and services. Section 4(d) provides that unless the Commission otherwise orders, no change shall be made by a gas company in any rate, charge, classification or service, except after 30 days' notice to the Commission and the public.

These requirements were fully met here. First, the court of appeals did not question that the purchase-deficiency method of allocating take-or-pay costs among a pipeline's customers satisfies the "just and reasonable" standard of Section 4(a). Second, Tennessee Pipeline complied with Section 4(c) by filing tariffs with the Commission that set forth its proposed allocation method; those tariffs were modified by the Commission pursuant to Section 5(a), and Tennessee filed new tariffs to implement the rates on a prospective basis. Third, Tennessee is in full compliance with Section 4(d) because it is collecting only those rates that have been filed with and approved by the Commission.

The legislative history of the NGA does not elaborate upon these provisions of Section 4, and therefore does not suggest that they should be construed to impose further restrictions not specified in the text of the Act itself. See H.R. Rep. No. 709, 75th Cong., 1st Sess. 4-5 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 4 (1937). Nor is there

any such suggestion in this Court's articulation in *Arkla* of the principles embodied in these statutory provisions: (1) rates filed with the Commission are lawful only if they are just and reasonable; (2) the authority to determine whether rates are just and reasonable is vested in the Commission; (3) no court may substitute its judgment for that of the Commission on the justness and reasonableness of rates; (4) "the right to a reasonable rate is the right to the rate which the Commission files or fixes" (quoting *Montana-Dakota*, 341 U.S. at 251); and (5) except where the Commission permits a waiver, "no regulated seller of natural gas may collect a rate other than the one filed with the Commission" (citing § 4(d)). 453 U.S. at 577. The Court explained that "[t]hese straightforward principles underlie the 'filed rate doctrine,' which forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Ibid.* The Commission fully respected these "straightforward principles" here; and Tennessee did nothing that the doctrine resting on these principles "forbids," since it charged only rates that were "properly filed" with the Commission.

Finally, the Commission's orders comport with what *Arkla* identified as the underlying purposes of the filed rate doctrine: "preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant." 453 U.S. at 577-578 (quoting *City of Cleveland* v. *FPC*, 525 F.2d 845, 854 (D.C. Cir. 1976)). See also *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 963 (1986) (the doctrine is "a rule of administrative law designed to ensure that federal courts respect the decisions of federal administrative agencies"). Here, there was no interference with the primary jurisdiction of the Commission (since it reviewed Tennessee's proposed rates), and the Commission obviously was "made cognizant" of those rates.[11]

[11] In *Arkla*, the Court held that, under governing preemption principles, the provisions of the NGA that comprise the filed rate doctrine

b. The court of appeals nevertheless believed that the Commission's orders violate the filed rate doctrine because, in its view, they impose a retroactive rate increase on Tennessee's customers. App., *infra*, 9a-11a. This conclusion likewise is not rooted in the relevant statutory provisions. The prohibition against retroactive ratemaking derives from Sections 4(d) and 5(a) of the NGA. Section 4(d) essentially requires a pipeline to charge the rates it has filed with the Commission and prohibits it from changing its rates without giving 30 days' notice to the Commission and the public (except where the Commission waives the latter requirement for good cause shown). As we have explained, Tennessee fully complied with these requirements. Section 5(a) provides that when the Commission finds a gas company's rate, practice or contract unreasonable, it "shall determine the just and reasonable rate, * * * practice, or contract to be *thereafter* observed and in force, and shall fix the same by order" (emphasis added). The Commission fully complied with this requirement because, after disapproving Tennessee's initial proposal, it fixed the rates and practices to be thereafter observed by Tennessee to recover a portion of its take-or-pay costs.

The Court explained in *Arkla* that Section 5(a) "bars the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate," and "prevents the Commission itself from imposing a rate increase for gas already sold," at least absent a waiver by the

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require state courts to give effect to rates filed with the Commission and to decisions of the Commission concerning those rates. In *Nantahala*, which arose under the parallel provisions of the Federal Power Act, 16 U.S.C. 824d, the Court similarly held that once the Commission sets the wholesale rate, a state commission is barred from concluding that that rate is not just and reasonable. Accord, *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354, 371-372 (1988). Questions concerning the effect to be given Commission decisions pursuant to the federal statutory provisions comprising the filed rate doctrine in the preemption context are not presented in this case, which involves a challenge to the actions of the Commission itself, not those of a state court or agency in a proceeding under state law.

Commission. 453 U.S. at 578 & n.8. But the Commission did neither of those things here: it did not retroactively substitute a higher rate for the one previously charged by Tennessee for past services, and it did not order Tennessee's customers to pay a higher price for gas they actually purchased during either the base period (1981-1982) or the deficiency period (1983-1986). The Commission instead ordered customers to pay a new rate on a prospective basis to cover a portion of the costs of Tennessee's settlement of its take-or-pay exposure, and it allocated those current costs among Tennessee's customers on the basis of the relative amounts of gas they did *not* purchase during the deficiency period.

The purpose of allocating take-or-pay costs in this manner is not to punish the customers who decreased their purchases from Tennessee during the deficiency period. The purpose, rather, is the essentially remedial one of allocating the additional costs Tennessee has now incurred as a result of those purchasing patterns. For this reason, and contrary to the court of appeals' belief, the fact that Tennessee's customers had a legal right to purchase gas elsewhere during the deficiency period does not *absolutely* preclude the Commission from taking these past purchasing patterns into account in fashioning an appropriate method for allocating current take-or-pay liability. That instead is one factor to be considered by the Commission in determining whether Tennessee's rates and practices for recovering a portion of its take-or-pay costs are "just and reasonable" —the central regulatory standard under the Act.

Applying that standard, the Commission permissibly concluded that the customers who caused Tennessee to accrue take-or-pay exposure by reducing their purchases should contribute proportionately to meeting a portion of the costs incurred by Tennessee in settling its liability. After all, Tennessee agreed to the take-or-pay clauses in order to assure a source of supply for the gas it expected those customers to purchase under the then-existing regulatory regime. See note 6, *supra*. Moreover, the purchase-

deficiency method of cost allocation serves the broader regulatory principle, consistently followed by the Commission and approved by the courts under the "just and reasonable" standard, of matching rates with responsibility for the underlying costs. See *Cities of Riverside and Colton* v. *FERC*, 765 F.2d 434, 439 (5th Cir. 1985); *Public Systems* v. *FERC*, 709 F.2d 73, 76 (D.C. Cir. 1983); *Alabama Electric Cooperative, Inc.* v. *FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982). The court of appeals therefore improperly utilized a rigid, judicially fashioned version of the filed rate doctrine to intrude upon the Commission's discretion under the statutory "just and reasonable" standard "to devise methods of regulation equitably reconciling diverse and conflicting interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

c. The court of appeals rejected the straightforward view of the filed rate doctrine as embodied in the relevant statutory provisions, as well as the compelling considerations underlying the Commission's regulatory approach in this case, on the ground that whether costs are "current" or "past" is not significant; rather, in its view, the critical inquiry concerns the "purchase decisions to which the costs are attached," since "[p]roviding the necessary predictability is the whole purpose of the * * * filed rate doctrine." App., *infra*, 9a, 10a. Apparently, the court believed that if Tennessee's customers had been apprised before they made their past purchasing decisions that a future rate would be based on those decisions, the filed rate doctrine would have been satisfied. But this was to require the impossible.

Tennessee could not have included any potential costs associated with its take-or-pay exposure in an earlier rate filing because it did not actually pay any monies to producers in settlement of that exposure—and therefore did not actually incur any costs—until shortly before its rate filing here. See note 9, *supra*. As a result, this is not a case in which "[t]he company having initially filed the rates and either collected an illegal return or failed to collect a suffi-

cient one must, under the theory of the Act, shoulder the hazards incident to its action including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate." *FPC* v. *Tennessee Gas Co.*, 371 U.S. 145, 153 (1962). To the contrary, Tennessee sought to collect an entirely new charge to recover *current* costs, based on circumstances that were dramatically different from those in existence when its earlier rates were on file.

Whatever role the "predictability" notion properly may play in construing the statutory provisions that embody the filed rate doctrine, the court below erred in relying on that notion to extend the scope of the filed rate doctrine so as to prohibit Commission actions that are fully consistent with the governing statutory provisions themselves.[12] Moreover, the court's notion of predictability in this context is based on the unrealistic assumption that clear purchasing choices always exist, and that customers can freely move from one pipeline system to another to avoid the payment of prudently incurred costs. Prior to open access, a customer's major purchasing decision was made when it signed a firm service sales contract with a pipeline. As a result, each pipeline's array of customers remained fairly constant, and the pipeline exercised its NGA author-

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[12] This Court in *Arkla* did not suggest that predictability for customers is, in itself, an enforceable tenet of the filed rate doctrine, especially where, as here, the requirements of the relevant statutory provisions have been satisfied. The notion of predictability was first articulated by the D.C. Circuit in *Electrical District No. 1* v. *FERC*, 774 F.2d 490, 492-493 (1985). In *Electrical District*, however, the court held only that the Commission failed to comply with the requirement under Section 206(a) of the Federal Power Act, 16 U.S.C. 824e(a) (which is identical for present purposes to Section 5(a) of the NGA), to make a new rate prospective, because it permitted the utility to collect the new rate as of a date prior to the Commission's acceptance of the utility's compliance filing. Thus, *Electrical District* relied on the predictability notion in construing the express terms of the statute. It did not suggest that a court may rely on its own perceptions of the importance of predictability to extend the filed rate doctrine in a manner divorced from the statutory text.

ity to file rate increases for recovery of newly incurred costs.

As the court below acknowledged, the Commission often utilizes "accurate historical data" in exercising its authority under Sections 4 and 5 of the NGA. See App., *infra*, 8a.[13] For example, in *City of Willcox* v. *FPC*, 567 F.2d 394, 408-412 (1977), cert. denied, 434 U.S. 1012 (1978), the D.C. Circuit endorsed the use, for the allocation of scarce supplies of natural gas, of base periods precisely like those at issue in this case. The court of appeals recognized as much, but sought to distinguish *City of Willcox* on the ground that a "curtailment plan is not a *rate* change." App., *infra*, 7a, 10a. This asserted distinction is unfounded. Section 4(d) of the NGA applies not only to rates, but also to "classifications" and "services," which include curtailment plans. A curtailment plan therefore is governed by the same statutory principles that comprise the rate doctrine. See also *Nantahala*, 476 U.S. at 966 ("the filed rate doctrine is not limited to rates *per se*").

The court below also erred in rejecting the Commission's reliance on the precedent of minimum bills, which likewise involve fixed charges that are not based on current or future takes of natural gas. The court acknowledged that in *Atlantic Seaboard Corp.* v. *FERC*, 404 F.2d 1268, 1269-1270 (D.C. Cir. 1968), it affirmed a minimum bill that was created through the use of a base period prior to the date on which the buyer commenced purchasing from another source—virtually the same type of base utilized here—but it sought to downplay that similarity by observing that the "charge was avoidable simply by keep-

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[13] The Commission's regulations require pipelines to submit with their rate-change applications data "based upon a test period which shall consist of a base period of 12 consecutive months of most recently available actual experience, adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of the filing * * *." 18 C.F.R. 154.63(e)(2).

ing takes above the minimum bill volume." App., *infra*, 11a. The true comparison, however, is that both *Atlantic Seaboard* and the instant case dealt with fixed charges based upon *past* purchasing practices, not with a true sales commodity rate. The court of appeals thus converted predictability into a principle of cost avoidance, which has no grounding in the relevant statutory provisions and which in this case clashes with other basic precepts of utility ratemaking.[14]

d. As we have explained, nothing in Sections 4 and 5 of the NGA imposes the rigid limitation on the Commission's allocation of current take-or-pay costs that the court of appeals announced in this case. Accordingly, because the purchase-deficiency method of allocation is consistent with the basic "just and reasonable" standard under the NGA, it is permitted by the Act. However, if the court of appeals believed that Sections 4 and 5 of the NGA are ambiguous in this regard, it should have deferred, under *Chevron*, 467 U.S. at 842-845, to the Commission's reasonable interpretation of those provisions as not imposing an absolute prohibition against the purchase-deficiency method of allocation. See also *PBGC* v. *LTV Corp.*, No.

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[14] The court of appeals apparently was also concerned that past customers who did not currently buy gas from Tennessee might have to pay their share of take-or-pay liability, although the court expressly declined to rest its decision on that ground. App., *infra*, 9a, 11a n.1. It is undisputed, however, that no customers of Tennessee who were assessed take-or-pay liability had left the system, and the Commission has informed us that, as a general matter, relatively few customers have abandoned all service obligations with their pipeline suppliers. If any customer of an interstate pipeline did abandon its service obligations before the pipeline sought to pass through take-or-pay costs, it is not assessed any liability. But where a downstream pipeline customer did not abandon those obligations prior to the upstream pipeline's filing of take-or-pay passthrough tariff sheets, the Commission, in allocating costs in a just and reasonable manner, has required abandoning downstream pipeline customers to share in the payment of the take-or-pay liabilities to which they contributed. See *United Gas Pipe Line Co.*, 47 F.E.R.C. ¶ 61,163 (1989).

89-390 (June 18, 1990), slip op. 12-17. Yet the court of appeals did not even mention this principle. Such deference is especially appropriate here, because the Commission must balance the impact on various customers of Tennessee against other statutory policies, including those favoring a competitive market and the policy consistently followed by the Commission and endorsed by the courts of allocating costs to those who caused them to be incurred.

2. For a number of reasons, the erroneous ruling by the court of appeals warrants review by this Court.

a. The decision below is not an isolated misapplication of the statutory provisions that comprise the filed rate doctrine. Since the decision was rendered, the D.C. Circuit has applied its novel and expansive view of the filed rate doctrine to invalidate other Commission orders that were designed to allocate costs in a just and reasonable manner during periods of transition experienced by natural gas pipelines. See *Public Utilities Comm'n* v. *FERC*, 894 F.2d 1373, 1382-1383 (D.C. Cir. 1990); *Transwestern Pipeline Co.* v. *FERC*, 897 F.2d 570, 576-581 (D.C. Cir. 1990); see also *Columbia Gas Transmission Corp.* v. *FERC*, 895 F.2d 791, 793-795 (D.C. Cir. 1990).[15] The view of the filed

[15] In *Transwestern*, the court appeared to recognize the flaws in relying on predictability as an independent standard for reviewing Commission orders. The court stated that its suggestion in prior decisions, including the instant case, that "a rate violates the filed rate doctrine because a customer cannot respond in some way that enables it to escape the charge" was "clearly inconsistent" with the Commission's power to permit a pipeline to change its rates under Section 4(d), even though customers cannot avoid the charges unless they undertake "the elaborate process of securing abandonment under § 7 of the Act." 897 F.2d at 579. The court nevertheless denied rehearing en banc in the instant case just one week later.

rate doctrine adopted by the D.C. Circuit in these cases is of nationwide significance and particular concern, because any party may seek review of any Commission order in that court. See 15 U.S.C. 717r(a).

b. The decision below seriously undermines the Commission's efforts to deal with the take-or-pay problem in a just and reasonable manner. The Commission's "equitable sharing" policy serves to spread the costs of resolving that problem over all segments of the industry. The purchase-deficiency method of allocating costs among pipeline customers — and the closely related provisions of Order No. 500-H that are designed to resolve the take-or-pay problem without extensive proceedings regarding the prudence of those costs (see note 5, *supra*) — are essential features of this policy, because they seek to match cost responsibility with cost incurrence and to ensure that the transition from pervasive governmental intervention in the natural gas market to greater reliance on market forces will be accomplished in an equitable fashion and with reasonable dispatch.

By contrast, the court of appeals' rejection of the purchase-deficiency method, if allowed to stand, would have a number of adverse consequences: (1) it would cause the Commission to depart from the accepted principle of cost responsibility, because other potentially available alternatives (*e.g.*, the volumetric surcharge and contract demand methods [16]) are not based on that principle; (2) it would unfairly burden those LDCs and other customers that were captives of the pipeline when other customers were able to buy cheaper gas elsewhere; (3) it would create

[16] The contract demand method would allocate take-or-pay liability on the basis of the amount of gas a customer is entitled to demand under its contract with a pipeline, irrespective of how much gas the customer actually purchases.

an incentive for customers who are able to do so to leave Tennessee and other systems that have substantial take-or-pay exposure in order to avoid the higher prices that would be imposed under alternative allocation methods, thereby exacerbating the take-or-pay problem; and (4) it would preserve distortions in the current market by misallocating costs resulting from past purchasing decisions. The dimension of these impacts is demonstrated by the amount of money at stake. Pipelines have already passed through to their customers under the purchase-deficiency method approximately $3.4 billion in costs they have incurred in buying out or buying down take-or-pay liability, and this case alone involves the allocation of $650 million in such liability.

The Commission has been struggling with the take-or-pay issue for some time in the context of the transition to a truly competitive market for natural gas, and the courts have kept prodding it to take action. Indeed, it was the D.C. Circuit, in *AGD I*, that most prominently faulted the Commission for not addressing the take-or-pay issue (in connection with Order No. 436, which approved the open-access policy for pipelines), and it was *AGD I* that led to the Commission's approach in Order No. 500 and here. Similarly, in another major case, the Fifth Circuit invalidated the Commission's Order No. 451, which set a higher price ceiling for "old" gas, in part because the Commission had not first resolved the pipelines' take-or-pay problems. *Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, 885 F.2d 209, 223-224 (1989), cert. granted, No. 89-1453 (June 4, 1990). Yet if the decision below is permitted to stand, uncertainties generated by those problems will continue to pervade the industry and hinder the Commission's regulatory efforts while it undertakes further proceedings on the allocation of take-or-pay costs.

c. Finally, the purchase-deficiency approach is both a logical outgrowth and an integral part of the major trans-

formation of the natural gas industry that Congress, the Commission, and market forces have wrought over the past 12 years. That method of cost allocation serves to reduce the windfall that certain pipeline customers would otherwise realize by virtue of their having been in a position to take advantage of some steps in that transformation (the elimination of minimum billing practices) by switching to cheaper sources of natural gas. If this particular component of the Commission's efforts to provide for a fair transition to a restructured and competitive natural gas market is struck down, the overall transition will be infected with a substantial inequity.

The legislative history of the Wellhead Decontrol Act of 1989, which lifted price controls on wellhead sales of "old" gas beginning in January 1993, discusses with approval the various Commission measures, including Orders Nos. 436 and 500, that were designed to bring about a more competitive market for natural gas and that made appropriate the enactment of the Wellhead Decontrol Act. See S. Rep. No. 38, 101st Cong., 1st Sess. 5 (1989); H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989). Because the D.C. Circuit's decision here effectively invalidates a central feature of Order No. 500, it eliminates one of the regulatory premises on which Congress acted in removing the last statutory obstacle to a fully competitive natural gas market by lifting controls on "old" gas. The Court should grant certiorari because the decision below invalidates a significant administrative measure undergirding the legislatively mandated transition to a competitive market.

## CONCLUSION

The petition for a writ of certiorari should be granted.
Respectfully submitted.

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*The Solicitor General is disqualified in this case.

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